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No. 07-221

FILED
SEP 20 2007
OFFICE OF THE CLERK
SUPREME COURT, U.S.

IN THE

Supreme Court of the United States

STAFF IT, INC.,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

BRIEF OF AMERICAN PAYROLL ASSOCIATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

Scott Mezistrano
American Payroll Association
1601 18th Street, NW
Suite 1
Washington, DC 20009
(202) 232-6888

Anne G. Batter*
**Counsel of Record*
Dean R. Morley
Thomas M. Cryan, Jr.
Baker & McKenzie
815 Connecticut Avenue, NW
Washington, DC 20006
(202) 452-7063

WILSON-EPES PRINTING CO., INC. – (202) 789-0096 – WASHINGTON, D. C. 20002

QUESTION PRESENTED

Whether federal courts should consider all facts and circumstances outlined in Treasury Regulations when determining if "reasonable cause" exists to justify abatement of penalties for an employer's failure to pay payroll taxes under 26 U.S.C. § 6651(a)(2), or its failure to deposit payroll taxes under 26 U.S.C. § 6656(a).

TABLE OF CONTENTS

	Page
QUESTION PRESENTED	ii
TABLE OF CONTENTS	iii
TABLE OF AUTHORITIES	iv, v
INTEREST OF THE *AMICUS CURIAE*	1
STATEMENT OF THE CASE	2
SUMMARY OF ARGUMENT	3
ARGUMENT	4
I. The Fifth Circuit's Holding is Contrary to the Policy Underlying Tax Penalties	4
II. Treasury Regulations Are Entitled to Deference and the IRS Cannot Assert a Position that is Contrary to Existing Treasury Regulations in Assessing a Penalty	5
CONCLUSION	8

TABLE OF AUTHORITIES

CASES:

Alumax, Inc. v. Commissioner, 109 T.C. 133 (1997) .. 6

Am. Campaign Acad. v. Commissioner, 92 T.C. 1053 (1989) 6

Baker v. Commissioner, 122 T.C. 143 (2004)..... 6

Beneficial Found., Inc. v. United States, 8 Cl. Ct. 639 (1985) 7

Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc. 467 U.S. 837 (1984)..... 5, 6

Cynthia L. Rowe v. Commisioner, 128 T.C. 13 (2007)..... 6

Dover Corp. v. Commissioner, 122 T.C. 324 (2004).... 7

Estate of McLendon v. Commissioner, 135 F.3d 1017 (5th Cir. 1998)..... 7

Estate of Rapp. V. Commissioner, 140 F.3d 1211 (9th Cir. 1988)..... 7

Nissho Iwai Am. Corp. v. Commissioner, 89 T.C. 765 (1987)..... 6

Rauenhorst v. Commissioner, 119 T.C. 157 (2002) 6, 7

Silco, Inc. v. United States, 779 F.2d 282 (5th Cir. 1986)..... 7

Staff IT, Inc. v. United States, 482 F.3d 792 (5th Cir. 2007)..... 3

Swallows Holding, Ltd. v. Commissioner, 126 T.C. 96 (2006)..... 6

United States v. Staff IT, Inc., 2006 WL 314440 (S.D. Tex. Feb. 9, 2006)..... 3

STATUTES:

26 U.S.C. 6651(a) 4
26 U.S.C. 6651(a)(2) ii
26 U.S.C. 6656(a) ..... ii, 4
Omnibus Budget Reconciliation Act of 1989, P-1-18 . 4

OTHER MATERIALS:

Code of Federal Regulations:

26 C.F.R. § 1.6161-1(b) 4, 5, 7
26 C.F.R. § 301.6651-1(c). 4, 5, 7
26 C.F.R. § 301.6651-1(c)(1). 3
26 C.F.R. § 601.601(d)(2)(v)(e) 6

Internal Revenue Manual:

I.R.M. 20.1.1.1.4(4)., Step 8 4
I.R.M. 20.1.1.2.1 4
I.R.M. 20.1.1.2.1(1) 4
I.R.M. 20.1.1.2.1(5) 4
I.R.M. 20.1.1.2.1(6) 5
I.R.M. 20.1.1.3.1.2(2)d 5

Revenue Procedure:

Rev. Proc. 89-14, 1981-1 C.B. 814 §7.01(5) 6

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BRIEF OF AMERICAN PAYROLL ASSOCIATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

INTEREST OF THE *AMICUS CURIAE*

The American Payroll Association submits this brief as *amicus curiae* in support of Petitioner in the above-captioned matter.[1]

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[1] No counsel for a party authored this brief in whole or in part, and no person or entity, other than *amicus curiae*, has made a monetary

The American Payroll Association ("APA") is a non-profit association representing payroll professionals. APA's members include over 23,000 payroll professionals, most of whom perform payroll-processing duties for approximately 17,000 employers. Additionally, APA's membership includes representatives of large, medium, and small payroll service providers who in turn process payrolls for an additional 1.5 million employers representing an aggregate total of one-third of the private sector workforce. The employers for whom APA members process payrolls are diverse in terms of business size, location, and industry. As payroll specialists, APA's members must determine proper employment tax withholding, prepare and file accurate information returns and statements, correct (when necessary) such information returns and statements, calculate and deposit taxes, and maintain all necessary payroll records. APA is concerned that the lower court's narrow application of the "reasonable cause" test for the abatement of penalties, which conflicts with both the statute and underlying regulations, would created undue hardship on its members. Accordingly, APA has a direct stake in the outcome of this case.

STATEMENT OF THE CASE

Petitioner Staff IT, Inc., engaged in the business of hiring and paying technical contractors and staffing them to outside business clients. These clients would pay Petitioner for the services. In 2001, the dot-com crash and the collapse of Enron triggered a severe economic downturn, particularly in Houston, where Petitioner encountered reduced demand for its contractors. Petitioner's financing company also declared bankruptcy.

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contribution to the preparation or submission of this brief. Written consent of the Petitioner and Respondent have been obtained and filed with the Clerk of the Court.

At that time Petitioner failed for three quarters to file, pay, and deposit payroll taxes as required by federal law. Petitioner did not scale back expenses until early 2002 when new financing was arranged. The company stabilized its finances by the end of 2002 and began to assume its tax obligations. However, the IRS pursued penalties, which are the subject of this appeal.

Petitioner presented a request to abate the penalties, which an IRS Appeals Officer denied. Petitioner then commenced suit in the District Court, which granted summary judgment for the government. *See United States v. Staff IT, Inc.*, 2006 WL 314440 (S.D. Tex. Feb. 9, 2006). In March 2007, the United States Court of Appeals for the Fifth Circuit affirmed. *See Staff IT, Inc. v. United States*, 482 F.3d 792 (5th Cir. 2007).

SUMMARY OF ARGUMENT

The lower court in this case held that neither "reasonable cause" nor "undue hardship" is present where a taxpayer fails to fire employees and cease all payments to creditors. This holding conflicts with both the statute and underlying regulations, and it ignores the Congressional intent and Internal Revenue Service ("IRS") policy for imposing tax penalties.

This petition involves only the failure to pay and the failure to deposit penalties, not the failure to file penalty. Whether or not a trier of fact determines that the conduct of this Petitioner ultimately excludes it from abatement of those two penalties, however, this court should grant the petition because Petitioner is correct in arguing that the lower court used an improperly narrow test that conflicts with the statute. Furthermore, substantial case law requires the IRS to follow its own regulations. The IRS should be prohibited from advocating a position that is directly contrary to 26 C.F.R. § 301.6651-1(c)(1).

ARGUMENT

I. THE FIFTH CIRCUIT'S HOLDING IS CONTRARY TO THE POLICY UNDERLYING TAX PENALTIES.

Sections 6651(a) and 6656(a) provide that the late filing penalty will not be imposed where the "failure is due to reasonable cause." "Reasonable cause" for a failure to pay is defined in the Treasury Regulations to include situations where the taxpayer's payment of the tax would result in undue financial hardship. 26 C.F.R. § 301.6651-1(c); 26 C.F.R. § 1.6161-1(b). Guidance on the policy behind these penalties and the reasonable cause standard can be discerned from the IRS's own Internal Revenue Manual ("IRM").

In 1987, the IRS formed a task force to study civil penalties and to address the systemic concern that penalties were not being imposed and enforced consistently among taxpayers. That task force, in conjunction with the overhaul of the penalty regime by the Omnibus Budget Reconciliation Act of 1989, resulted in the 1992 adoption of the Service's first penalty policy, P-1-18. This policy is incorporated in the current version of the IRM.

The IRM makes clear that the purpose of penalties is to support and encourage voluntary compliance. *See* IRM 20.1.1.2.1. According to the IRM, each case should be resolved in a manner that promotes voluntary compliance. IRM 20.1.1.1.4(4), Step 8. *See also* IRM 20.1.1.2.1(1) (penalties exist to encourage voluntary compliance); IRM 20.1.1.2.1(5) (penalties advance the mission of the Service when they encourage voluntary compliance). Voluntary compliance is achieved when a taxpayer makes a good faith effort to meet the

requirements of the law. IRM 20.1.1.2.1(6). The IRM acknowledges that taxpayers sometimes take sufficient action to meet their obligations, but as a consequence of factors beyond their control, are unable to do so. Critical to the reasonable cause determination is whether "the taxpayer exercises ordinary care and prudence but, due to circumstances beyond the taxpayer's control, the taxpayer was unable to timely meet the tax obligation." IRM 20.1.1.3.1.2(2)d.

Imposing penalties where the taxpayer's failure to pay was caused by financial distress is contrary to the IRS's own internal policy. Imposing penalties where the taxpayer is already facing severe financial hardship will do nothing to further voluntary compliance. We understand that whether the taxpayer's financial condition affected the failure to pay the taxes is a question of the fact, but courts should be able to consider this factor in determining whether reasonable cause exists. The Fifth Circuit's narrow interpretation of the statute prevents courts from considering this factor.

II. TREASURY REGULATIONS ARE ENTITLED TO DEFERENCE AND THE IRS CANNOT ASSERT A POSITION THAT IS CONTRARY TO EXISTING TREASURY REGULATIONS IN ASSESSING A PENALTY

As previously noted, "reasonable cause" for a failure to pay is defined in the Treasury Regulations to include situations where the taxpayer's payment of the tax would result in undue financial hardship. 26 C.F.R. § 301.6651-1(c); 26 C.F.R. § 1.6161-1(b). Courts are not permitted to simply disregard a long-standing Treasury Regulation when interpreting a statute. In *Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984), the Court stated that when reviewing an agency's regulatory implementation of a statute, we look first to whether

Congress has directly spoken to the precise question at issue. *Id.* at 842. If congressional intent is clear, the courts inquiry should end, and the court should apply the unambiguously expressed intent of Congress. *Id.* at 842-843. However, if congressional intent is not clear, the question is whether the regulation is based on a permissible construction of the statute. *Id. See also Cynthia L. Rowe v. Commissioner,* 128 T.C. 13 (2007) (Treasury Regulations have the force and effect of law unless unreasonable under the statute); *Swallows Holding, Ltd. v. Commissioner,* 126 T.C. 96 (2006) (same). To include "financial hardship" as a consideration for determining "reasonable cause" is a reasonable interpretation of the statute. The Fifth Circuit should not be permitted to remove the impact of financial hardship from consideration of what constitutes reasonable cause for a delay in the payment and filing of taxes.

In addition, the IRS's own policy is to allow taxpayers to rely on published guidance. *See* 26 C.F.R. § 601.601(d)(2)(v)(e) ("Taxpayers generally may rely upon Revenue Rulings published in the Bulletin in determining the tax treatment of their own transactions and need not request specific rulings applying the principles of a published Revenue Ruling to the facts of their particular cases [where] the facts and circumstances are substantially the same."); Rev. Proc. 89-14, 1989-1 C.B. 814, § 7.01(5) (same). The courts agree that taxpayers are entitled to rely on IRS published guidance. *See Baker v. Commissioner*, 122 T.C. 143, 164 n.21 (2004) (confirming that "the public has a right to rely on positions taken by the Commissioner" in revenue rulings) (citing *Alumax, Inc. v. Commissioner*, 109 T.C. 133, 163 n.12 (1997); *Am. Campaign Acad. v. Commissioner*, 92 T.C. 1053, 1070 (1989); *Nissho Iwai Am. Corp. v. Commissioner*, 89 T.C. 765, 778 (1987)). *See also Rauenhorst v. Commissioner*, 119 T.C. 157, 182-83 (2002) ("[T]axpayers should be entitled to rely on revenue rulings in structuring their

transactions, and they should not be faced with the daunting prospect of the Commissioner's disavowing his rulings in subsequent litigation.").

In fact, the courts require the IRS to follow its own rulings. *Rauenhorst v. Commissioner*, 119 T.C. 157, 170-71 and n. 10 (2002) (Commissioner is bound by his revenue rulings); *Dover Corp. v. Commissioner*, 122 T.C. 324, 350 (2004) (following *Rauenhorst*); *Estate of* McLendon *v. Commissioner*, 135 F.3d 1017, 1024 (5th Cir. 1998) ("[T]he Commissioner will be held to his published rulings...."); *Estate of Rapp v. Commissioner*, 140 F.3d 1211, 1216-17 (9th Cir. 1988) ("[R]evenue rulings...may limit the IRS's ability to assert a position that is contrary to that asserted in the ruling if the ruling is published, to the extent that the ruling addresses a similar issue."); *Silco, Inc. v. United States*, 779 F.2d 282, 287 (5th Cir. 1986) (requiring the IRS to follow revenue rulings); *Beneficial Found., Inc. v. United States*, 8 Cl. Ct. 639, 645 n.7 (1985) ("[Revenue] rulings can provide no guidance to taxpayers if the Service and the courts fail to give them effect in litigation.").

The rationale behind limiting the IRS's ability to disregard revenue rulings is even stronger with respect to Treasury Regulations, which have received notice and comment from the public and have been published in the Federal Register. The IRS cannot disregard reliance on 26 C.F.R. § 301.6651-1(c) and 26 C.F.R. § 1.6161-1(b) and develop its own narrow interpretation of "reasonable cause." If the IRS seeks to change the regulatory definition, the change should be promulgated through new regulations.

CONCLUSION

For the foregoing reasons, *Amicus* respectfully requests that this Court grant the petition for writ of certiorari.

Respectfully submitted,

Anne G. Batter*
Dean R. Morley
Thomas M. Cryan, Jr.
Baker & McKenzie
815 Connecticut Avenue, NW
Washington, DC 20006
(202) 452-7063

Scott Mezistrano
American Payroll Association
1601 18th Street, NW
Suite 1
Washington, DC 20009
(202) 232-6888

*Counsel of Record
September 20, 2007